

# TRANSACTION PRIVILEGE TAX (TPT) SIMPLIFICATION

## GENERAL

- It's widely acknowledged that Arizona's TPT ("sales tax") system is complicated and overly burdensome for the business community.
- It's an accountant's dream, but a business-owner's nightmare.
- It is difficult for taxpayers to adhere to multiple tax bases and multiple varying interpretations.
- Governor Brewer has been a strong advocate for sales tax simplification for the entire 30 years she's been an elected official in Arizona.
- Our system results in multiple licensing requirements, multiple tax returns, multiple state and local tax bases, multiple audits, and multiple varying state and local interpretations of the code in audit.
- Taxpayers shouldn't have to carry the administrative burdens of multiple governmental tax administrations that can't get their act together.
- Consumers don't have to be experts in the sales tax code in order to pay it at the cash register. It should be the same for our business taxpayers.
- Business should be focused on the special skills their employees bring to the marketplace, not on some byzantine series of tax codes about which even tax experts disagree.
- A tax system should be simple with minimal compliance and administration costs.
- The sales tax is Arizona's most important revenue source – almost 50% of the state's general fund revenues. We need to get our system in order.

## STATE ADMINISTRATION AND AUDIT

- Nearly all of the 7,000 sales tax jurisdictions in the U.S. are administered by the state, except in Alabama, Colorado, Louisiana, and Arizona.
- ADOR already administers the taxes on behalf of the 73 program cities.
- Arizona's responses to the multiplicitous nature of our sales tax code have served more to highlight the problems than to remedy them.

- The shift in consumer behavior toward online retail over the past decade has cost Arizona tax revenue, jobs and local economic activity.
- A recent NCSL study estimates Arizona's lost revenue at \$709 million due to remote sales activity.
- Any federal legislation designed to clarify state taxation of remote sales will require Arizona to simplify its tax code significantly.
- Ultimately, what Arizona needs is what businesses in other states have: one payment, one point of contact, one audit.

### **SALES TAX ON CONTRACTING**

- The state's sales tax on contracting is complicated and confusing.
- We are one of only a small number of states that have a contracting tax like this.
- Most states impose a sales tax on a contractor's purchase of building materials, treating the contractor as the ultimate consumer of those materials.
- Only Hawaii, New Mexico, Washington and West Virginia tax contracting like Arizona does. But at least those states administer uniform tax systems.
- City sales taxation of contractors, speculative builders and owner-builders differs from the state sales tax laws.
- The current system makes it very difficult to determine which activities are subject to tax.
- Contracting taxes is one of 16 sales tax classifications, but it represents 25% of the state audits, which is disproportionate to the 10% of revenues derived from it.
- The confusion, controversy, litigation, legislation, and frustration associated with this tax method is far disproportionate to the revenues generated from it.
- Complicated and confusing tax systems result in noncompliance with the tax code.
- ADOR has estimated the noncompliance at 31% in the prime contracting classification alone. That figure is based on 2010 data from ADOR and U.S. Census Bureau.

## **Q&A ON STATEWIDE TPT ADMINISTRATION**

### **Does the Arizona Department of Revenue have the resources to handle statewide TPT administration?**

- ADOR already administers TPT for the 73 program cities and the Task Force recognized that ADOR will need additional resources to administer TPT on behalf of the 18 non-program cities.

### **Will cities receive enough information from ADOR to develop revenue forecasts?**

- Yes. For the 73 program cities, ADOR currently provides the taxpayer name, total amount paid, the period covered, and the taxpayer NAICS code. In addition, ADOR recognizes that some of the current systems need to be reformed to ensure that cities receive sufficiently detailed information.

### **Will cities receive timely revenue distributions from ADOR?**

- Yes. Currently, ADOR distributes revenue to cities on a weekly basis. Additionally, ADOR and ADOA are in the midst of IT upgrades that will enable more frequent distributions.

### **Will cities lose the revenue that is currently generated from licensing fees?**

- Licensing fees will be addressed as part of the efforts to standardize licensing across jurisdictions. Currently the state does not charge an annual renewal fee while some cities do.

## **Q&A ON SINGLE AUDIT**

**Last year, city auditors identified far more unreported tax in the non-program cities than ADOR did. Does that mean ADOR will not identify and collect that revenue in the future?**

- No. It is no surprise that ADOR identified a lower amount of unreported tax because ADOR only audits in a non-program city if a taxpayer elects a multi-jurisdictional audit, which rarely happens. With additional audit staff at ADOR, there should be no decline in the amount of unreported tax that is identified and collected.

**Does the Arizona Department of Revenue have the resources to audit on behalf of all cities?**

- ADOR already audits on behalf of the 73 program cities and the Task Force recognized that ADOR will need additional resources to audit on behalf of the 18 non-program cities.

**Does the Arizona Department of Revenue have the expertise to audit on behalf of all cities?**

- ADOR auditors have years of experience auditing on behalf of the 73 program cities. When unique situations arise, ADOR will continue to consult with staff from the city finance departments.

**Will a single audit be more difficult, complex and time consuming for taxpayers?**

- No. The difficulty for taxpayers is that they must adhere to a tax base that lacks uniformity and, at times, varying interpretations of the base.

## Q&A ON CONTRACTING

### What's the problem with a sales tax on contracting?

- The state's sales tax on contracting is complicated and confusing. It results in more audits and litigation than any other classification. Complexity and confusion result in furthering noncompliance.
- Even determining who the "prime contractor" is can be difficult because of the variety of construction arrangements.
- There are significant dollar amounts associated with taxable transactions that go uncollected.

### Which other states tax contracting the way Arizona does?

- Hawaii, New Mexico, Washington and West Virginia. The norm in other states is to impose a sales tax on contractor's purchase of building materials, treating the contractor as the ultimate consumer of those materials.

### Is it appropriate to use data from a study that was published in 1999 to estimate the impact of a transition to a materials based tax today?

- The ADOR estimates are based solely on the methodology used in the 1999 study but not the 1992 data used in it. The updated estimates are based on 2010 data from ADOR and the U.S. Census Bureau.

### Will cities lose revenue as a result of the shift to a materials based tax?

- There are many factors that will impact whether a city ends up gaining or losing revenue, but *in general*:
  - Cities will receive **more shared revenue** because the retail classification is shared at a higher rate than the contracting classification (40% vs. 20%)
  - Cities will receive **more revenue** because compliance will increase when materials are taxed at the point of sale. Examples of non-compliance include use of exemption certificates for non-contracting activities and contractors doing work "under the table" and failing to collect tax. ADOR

estimates a non-compliance factor of 31%, which is more conservative than the value used in the 1999 study.

- The current practice of levying the tax on 65% of the value the contracting activity likely overstates the value of materials. In such cases, taxing the materials directly will generate **less revenue** for the both state and the cities.
- City revenues will shift from the location where the contracting activity occurs to the location where the materials are purchased. This will **increase revenues** for some cities and **decrease revenues** for others.
- When considering the varying impacts that this recommendation could have on each city, it is important to consider the impact of the other Task Force recommendations. In particular, the collection of taxes on remote sales and the sourcing of those sales to the delivery location will generate additional revenue at the city level.

**As the construction market improves, will the revenue loss increase?**

- Perhaps, but a smaller revenue increase resulting from construction growth is not the same as a revenue decrease.